



**Report to the Senior Executive Council,  
Department of Defense**

## **WORKING CAPITAL FUND TASK GROUP**

### **Report FY03-6**

- **Recommendations related to the financial and operational management of the Defense Working Capital Fund**

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**July 30, 2003**

## MANAGEMENT OF THE WORKING CAPITAL FUND TASK GROUP REPORT

**BACKGROUND:** The Defense Working Capital Fund (DWCF) is a revolving fund financial mechanism that involves approximately 200,000 civilian and military personnel providing more than \$85 billion in goods and services. About 20% of DoD's direct appropriation dollars flow through the DWCF on an annual basis. The activities financed in the DWCF form the Department's main organic logistics capability. The DWCF activities rely on sales revenue rather than direct appropriations to finance their operations. DWCF financing is intended to generate sufficient revenue to cover the full costs of its operations, and to provide the flexibility to finance the fund's continuing operations, and therefore customer services, without fiscal year limitation.

The basic tenet of the revolving fund system is to provide the mechanism to enable the effective and efficient provision of services to customers. In DoD those services range from supply management to information services. The financial mechanisms of the DWCF are intended to provide total cost visibility and full cost recovery, and to provide customers with reasonable and consistent charges for services provided. The DWCF achieves these goals and maintains mission-readiness through stabilized billing rates charged to customers, i.e., rates will not fluctuate during a given year of execution. Additionally, the revolving fund principles of total cost visibility and full cost recovery mean there are no hidden costs, and customers are charged for the complete cost of goods and services.

There are five major Working Capital Funds within DoD performing various business activities or functions. They are:

Army Working Capital Fund

Army Supply Management

Army Depot Maintenance

Army Ordnance

Army Information Services

## Defense Business Practice Implementation Board

### Navy Working Capital Fund

Navy Supply Management  
Navy Depot Maintenance  
Navy Research and Warfare Centers  
Navy Public Works  
Marine Corps Supply Management

### Air Force Working Capital Fund

Air Force Supply Management  
Air Force Depot Maintenance  
Air Force Information Services  
Transportation (TRANSCOM)

### Defense-Wide Working Capital Fund

Defense Finance and Accounting Service (DFAS)  
Defense Information Systems Agency (DISA)  
Defense Logistics Agency (DLA)  
Defense Security Service (DSS)

### Defense Commissary Agency (DeCA)

DeCA Operations  
DeCA Resale

Each of the five major funds operates on a break-even basis over time; that is, it neither makes a profit nor incurs a loss. However, should a profit or a loss occur, the business area would either lower its prices in a subsequent fiscal year, or raise prices in order to realize sufficient funds to cover costs and the realized loss.

Each revolving fund activity is provided with annual Operating and Capital Budgets.

- *The Operating Budget* includes all direct, indirect, and general & administrative costs, including expenses for depreciation of assets. Costs include labor, non-labor, materials, supplies, utilities, real property maintenance, personnel and payroll support.
- *The Capital Budget* includes funding of investment items for industrial equipment, construction, telecommunications equipment, IT infrastructure, and software.

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Oversight of DWCF activities comes from a range of organizations, including, for financial aspects, the Office of the Under Secretary of Defense (Comptroller). DoD Components designate a management agency or command to be responsible for the day-to-day financial management and functional operation of each DWCF business area. The customers provide the primary oversight role as informed buyers of the services and goods produced by the DWCF activities. The Components also provide periodic financial and management information as required by the OUSD(C).

**TASK:** The Defense Business Practice Implementation Board (DBB) was tasked with providing recommendations on improving the management of the DWCF. In the absence of a profit motive, it has been difficult to translate and adopt modern management tools to drive operational and financial improvements, which are critical to the Secretary of Defense's transformation efforts.

The Task Group was asked to evaluate current management practices for the DWCF and to provide the following deliverables:

1. Identify those areas in the DWCF with the most significant opportunities for improved management based on best business practices in the private sector.
  2. Develop an action plan for implementation of the specific recommendations.
- DBB Task Group Chairman: William R. Phillips
  - DBB Task Group Members: Neil Albert, Andrew Siegel
  - DoD Task Group Sponsor: Lawrence J. Lanzillotta, Principal Deputy and Deputy Under Secretary of Defense for Management Reform
  - DoD Liaison: Jeanne Karstens, Director of Revolving Funds
  - DBB Staff: Kelly S. Van Niman (Executive Secretary) and Alexander F. Zemek (Defense Fellow)

**PROCESS:** The Task Group met with its DoD Sponsor and others in the Office of the Under Secretary of Defense (Comptroller) to gain an understanding of their views with respect to those areas of greatest management concern. The Task Group subsequently held several discussions with its DoD Liaison to define the scope of the Task Group's review. Based on those discussions it was agreed that the Task Group would focus on the following areas:

## Defense Business Practice Implementation Board

- Leadership and accountability
- Performance incentives
- Training and job requirements
- Rate and budget development
- Metrics and financial reporting

Upon the recommendation of the Task Group's Liaison, the Task Group met with key individuals from Army WCF, Navy WCF, Air Force WCF and the Defense Logistics Agency, which has financial accountability for the Defense-wide WCF. Each representative held primary management responsibility for either operational performance or cash management of their respective Fund. The Task Group is grateful to them for their candid comments and advice for improving the understanding within the Department of DWCF activities, and areas for improved management of the Fund's business practices.

**RESULTS:** After completing its review of current management practices within the DWCF, and benchmarking those practices against private industry best practices, the Task Group concluded that the DWCF is critical to the ongoing business transformation of the Department of Defense. These funds provide excellent opportunities to test new business practices and implement many initiatives consistent with the Defense Transformation Act. This conclusion is based on the beliefs that the Funds provide cost visibility and the financial mechanisms to drive out excess cost, while improving customer service, and that the Funds provide an opportunity to leverage commercial best practices into common business operations. Please see Attachment A for the Task Group's complete observations and recommendations.

### *Summary Recommendations*

The Task Group recommends the following actions:

#### Operations Management

- Create a single General Manager (civilian) for each fund (Army, Navy, Air Force, Defense-wide, Defense Commissary) and each business activity (supply, depot maintenance, etc.).
  - Person(s) responsible for financial, operational and customer satisfaction performance of the Fund/business activity, with their performance tied to specific metrics.

## Defense Business Practice Implementation Board

- Transfer military leadership to civilian wherever possible for operations within funds.
  - Improve management continuity
  - Support ongoing initiatives of the Defense Transformation Act
- Develop/implement a balanced scorecard for the DWCF and DoD leadership.
  - Consistent with the approach to the DoD-wide balanced scorecard currently under development
  - Should measure financial, operational and customer satisfaction
  - See Appendix B of Attachment A for a list of recommended liquidity and solvency financial metrics.

### Cash Management

- Standardize accounting and financial definitions and policies across all funds.
  - Consistent with BMMP
  - Will facilitate business reporting and analysis
- Remove the extraordinary expense of system shutdowns from annual rates to avoid significant rate fluctuations. Use appropriated funds to cover BMMP related system shutdowns.
  - e.g. DPPS shutdown resulted in \$100 million loss
- Allow capabilities-based budgeting.
  - Critical for IT and some capital programs
- Modify the rate development and budgeting processes to provide better visibility into customer demand before finalizing rates.
- Support MID 903 initiatives in rate structure areas.

## Defense Business Practice Implementation Board

- Establish formal training program.
  - Consistent for all funds, tying operations to financial management - - apply best practices like the Air Force training game
  - Leverage eLearning best practices

**NEXT STEPS:** The Task Group recommends that the Comptroller task the DWCF Corporate Board to review its recommendations and develop an action plan for implementing its recommendations wherever possible.

Respectfully submitted,

William R. Phillips

Attachments:

A) Final Report Presentation



DEFENSE BUSINESS PRACTICE IMPLEMENTATION BOARD

# **Management of the Working Capital Fund**

**Final Report  
July 30, 2003**



## Sponsors

- Larry Lanzillotta (Principal Deputy & DUSD, Management Reform)
- Jeanne Karstens (Director of Revolving Funds and DoD Liaison)

## Task Group Members

- Bill Phillips (Chairman)
- Neil Albert
- Andrew Siegel
- Kelly Van Niman (Executive Secretary)
- Alex Zemek (Defense Fellow)



## Background

- **WCF, or predecessor financial mechanisms have been around since the Defense Act of 1947**
- **Perceptions of senior leadership are that the WCF aren't effectively or efficiently managed**

## Objective

- **Identify areas for improved management within WCF and make recommendations for applying private sector best practices**



## Scope

- **Review**

- Leadership and accountability
- Performance incentives
- Training and job requirements
- Rate and budget development
- Metrics and financial reporting

## Process

- **Review WCF activities; interview financial and logistics personnel; document observations; draw conclusions; make recommendations**

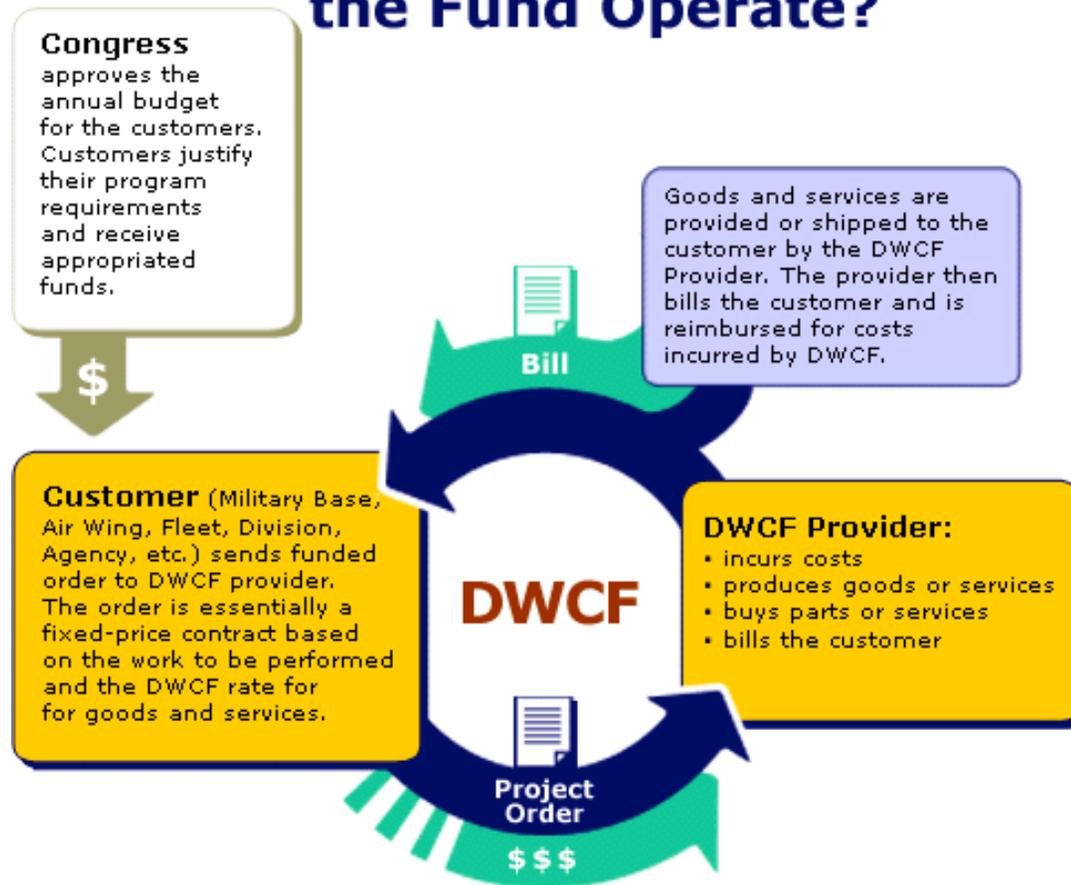


**WCFs have a significant impact on dollars and people:  
DWCF Budget = \$85.716 B w/203 K personnel**

- **Army Working Capital Fund (\$8.7B w/20 K per.)**
- **Navy Working Capital Fund (\$22 B w/83 K per.)**
- **Air Force Working Capital Fund (\$20.4 B w/45 K per.)**
- **Defense-wide Working Capital Fund (\$28.2 B w/40 K per.)**
- **Defense Commissary Agency Fund (\$6.3 B w/15 K per.)**



## How Does the Fund Operate?





## **Defense Working Capital Fund Activities Include:**

- Maintenance
- Supply
- Financial Operations
- Shipyards
- Ordnance
- Information Systems
- Security
- Telecommunication
- Research & Development



## Operations Management

- **Leadership and Accountability**
- **Training and Skills of WCF Professionals**
- **Incentives and Structure**

## Cash Management

- **Rate Determination (Budget Process)**
- **Capital Budgeting Process**
- **Capitalization and Depreciation Discipline**



# Operations Management Observations

## *Leadership and Accountability*

- **Senior leadership perspective**
  - Demonstrate lack of understanding of WCF
  - Receive limited metrics from WCF
- **Existing metrics focus on financial and operational, not customer satisfaction**
  - Metrics are not consistent across the activities
  - DLA has created a balanced scorecard
- **Elements of WCF don't come together until too high in the "chain of command"**



# Operations Management Observations

## *Leadership and Accountability*

- **Accountability for WCF activities widespread**
- **Many WCF activity leaders don't have right blend of skills**
  - Most lack appropriate financial background – particularly cost management
  - Logistics/operations skills are generally strong



# Operations Management Observations

## *Training and Skills of WCF Professionals*

- **Management staff don't have good blend of budget, accounting and program expertise**
  - Emphasis typically on budgeting
- **ERP initiatives will increase training needs**
- **Typically rely on On-The-Job-Training**
- **Training, where it exists, is inconsistent between Funds**
  - Air Force has developed “training game”
- **Not prepared for potential retirement wave**



# Operations Management Observations

## *Incentives and Structure*

- **WCF structure allows flexibility to respond to customer**
- **Customer-provider relationship is the basis of WCF**
- **Inconsistent application of performance-based contracts or incentives to improve rates, e.g., supply or maintenance rates**
- **On-going process to determine what belongs in WCF**



# Cash Management Observations

## *Rate Determination (Budget Process)*

- **Rates are determined based on prior year's approved programs and future anticipated demand**
- **Actual demand isn't defined until end of Planning Programming, Budgeting & Execution process**
- **No formal iterative process to cycle back and rebalance rates during year of execution to match program requirements**



# Cash Management Observations

## *Rate Determination (Budget Process)*

- **Budget process is too slow with execution/delivery of services occurring 2 years after rate determination**
  - Funds do have flexibility during year of execution
- **Rates for Defense-wide Fund Activities built without visibility into what customers plan to spend (unlike Service Funds, don't control appropriations)**



# Cash Management Observations

## *Capital Budgeting Process*

- **Dollar threshold same for all Funds (> \$100K with > 2 years useful life), and depreciation expense included in all Funds' rates**
- **Review procedures differ among Funds (all receive final OSD approval)**
  - Impact on future rates (ROI)
  - Compatibility of investment with mission/automation efforts



# Cash Management Observations

## *Capital Budgeting Process*

- **Some have strong and disciplined process others believe time is ripe for change**
- **Desire ability to budget by capabilities vs. line items (e.g. IT and capital purchases)**



## Cash Management Observations

### *Capitalization and Depreciation Discipline*

- **Implementation of Business System Modernization and BMMP could lead to shut down of many systems, resulting in immediate write-downs of depreciation expenses**
  - Suggest funds be appropriated to cover one-time expense so Services don't have to pay surcharge in rates (DPPS was a \$100 million write-off)
- **Depreciation costs for weapons systems and buildings aren't included all rates (e.g. TRANSCOM) making them lower than they could/should be**



## Summary Perspective

- **WCFs provide mechanism for the business transformation of the Department**
  - Provide cost visibility and the financial mechanisms to drive excess costs out while improving service
  - Provide opportunity to leverage commercial best practices into common business operations



## Operations Management Recommendations

- 1) **Create single General Manager (civilian) for each fund (Army, Navy etc.) and fund component (Supply, Depot Maint. etc.)**
  - Responsible for financial, operational and customer satisfaction performance, tied to specific metrics
- 2) **Transfer military leadership to civilian wherever possible for operations within funds**
  - Improve management continuity
  - Support ongoing DoD human capital initiatives



## Operations Management Recommendations

### **3) Develop & implement balanced scorecard for WCF and DoD leadership**

- Consistent with the approach to the DoD-wide balanced scorecard under development
- Containing financial, operational and customer satisfaction metrics
- Liquidity and Solvency financial metrics are included in Appendix B for consideration



## Cash Management Recommendations

- 1) **Standardize accounting and financial definitions and policies across all funds**
  - Consistent with BMMP
  - Will facilitate reporting and analysis
- 2) **Remove the extraordinary expense of systems shutdowns from annual rates to avoid significant rate fluctuations. Use appropriated funds to cover BMMP related system shutdowns.**
  - e.g. DPPS shutdown resulted in \$100 million loss
- 3) **Allow capabilities based budgeting**
  - Critical for IT and some capital programs



## Cash Management Recommendations

- 4) Modify rate development and budgeting process to provide better visibility into customer demand before finalizing rates**
- 5) Support MID 903 initiatives in rate structure areas**
- 6) Establish formal training program**
  - Consistent for all funds, tying operations to financial management – Apply best practices like AF training game
  - Leverage eLearning best practices



- **USD (Comptroller) to task the Service/Agency Financial Managers/Comptrollers to designate a senior level representative to work with OUSD(C) staff to implement financial management recommendations and provide input of operational management recommendations**
- **USD (Comptroller) to send action memo to SecDef to endorse DBB recommendations**



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## **Appendix A**

### WCF Financial Profiles



## WCF Financial Profile - Army

FY 2004	Obligation	Capital	Memo:	Total OA	Civilian FTE	Average Military	Total Pers
	<u>Authority (OA)</u>		Direct Appn				
Army Supply	6,151.3	42.9	219.3	6,194.2	2,937	13	2,950
Depot Maint	1,777.6	44.1		1,821.7	11,054	119	11,173
Ordnance	654.2	58.5		712.7	5,581	18	5,599
Info Svcs	-	-		-			-
<b>subtotal Army</b>	<b>8,583.1</b>	<b>145.5</b>	<b>219.3</b>	<b>8,728.6</b>	<b>19,572</b>	<b>150</b>	<b>19,722</b>



## WCF Financial Profile - Navy

FY 2004	Obligation		Memo:		Civilian FTE	Average Military	Total Pers
	<u>Authority (OA)</u>	<u>Capital</u>	<u>Direct Appn</u>	<u>Total OA</u>			
Navy Supply	6,703.9	49.8	130.4	6,753.7	5,334	424	5,758
MC Supply	160.6	-		160.6	26	-	26
Shipyards	1,392.4	15.2		1,407.6	11,250	80	11,330
NADEPS	1,915.8	39.3		1,955.1	10,029	127	10,156
MC Depot Maint	193.8	4.0		197.8	1,217	12	1,229
Base Support	1,494.7	19.3		1,514.0	8,300	108	8,408
R&D	8,261.3	109.2		8,370.5	37,706	631	38,337
Navy Transportation	1,691.6	13.1		1,704.7	6,466	624	7,090
<b>subtotal Navy</b>	<b>21,814.1</b>	<b>249.9</b>	<b>130.4</b>	<b>22,064.0</b>	<b>80,328</b>	<b>2,006</b>	<b>82,334</b>



## WCF Profile – Air Force

FY 2004	Obligation		Memo:		Civilian FTE	Average Military	Total Pers
	<u>Authority (OA)</u>	<u>Capital</u>	<u>Direct Appn</u>	<u>Total OA</u>			
Air Force Supply	9,542.5	53.5	39.8	9,596.0	2,462	60	2,522
Depot Maint	5,468.2	167.4		5,635.6	21,966	238	22,204
Info Svcs	622.6	10.6		633.2	1,221	809	2,030
TRANSCOM	4,344.4	197.0		4,541.4	4,094	14,592	18,686
<b>subtotal Air Force</b>	<b>19,977.7</b>	<b>428.5</b>	<b>39.8</b>	<b>20,406.2</b>	<b>29,743</b>	<b>15,699</b>	<b>45,442</b>



## WCF Profile – Defense Agencies

FY 2004	Obligation		Memo: Direct		Civilian FTE	Average Military	Total Pers
	Authority (OA)	Capital	Appn	Total OA			
DLA Supply	20,598.9	213.3	242.7	20,812.2	11,252	371	11,623
DLA Distribution	1,472.8	58.3		1,531.1	8,016	178	8,194
DLA DRMS	287.0	7.7		294.7	1,641	9	1,650
DLA Printing	383.2	-		383.2	723	-	723
DFAS Financial Ops	1,553.4	105.1		1,658.5	13,130	936	14,066
DFAS Info Svcs	199.9	1.0		200.9	1,200	10	1,210
DISA Computing Svcs	616.9	72.7		689.6	2,244	14	2,258
DISA Telecomm	2,577.6	87.2		2,664.8	533	35	568
DSS Security	-	-		-	-	-	-
<b>subtotal Defense-wide</b>	<b>27,689.7</b>	<b>545.3</b>	<b>242.7</b>	<b>28,235.0</b>	<b>38,739</b>	<b>1,553</b>	<b>40,292</b>



## WCF Profile – Defense Commissary

FY 2004	Obligation		Memo:		Civilian FTE	Average Military	Total Pers
	Authority (OA)	Capital	Direct Appn	Total OA			
Commissary Resale	5,162.7			5,162.7	-	-	-
Commissary Operations	1,111.3	7.8	1,111.3	1,119.1	14,980	13	14,993
<b>subtotal DeCa</b>	<b>6,274.0</b>	<b>7.8</b>	<b>1,111.3</b>	<b>6,281.8</b>	<b>14,980.0</b>	<b>13.0</b>	<b>14,993.0</b>



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## **Appendix B**

# Liquidity and Solvency Financial Metrics



# Liquidity and Solvency Metrics for Financial Statement Analysis

## *Rationale*

- **Non-financial managers frequently cite difficulties in interpreting financial reports from WCF entities**
- **Managers should focus on liquidity and solvency**
  - Cited as major concerns among managers
- **Consistent measures should be applied across all Funds in the WCF**



- **Inventory Turnover Ratio**

- Identifies the frequency in which WCF activities sell inventory and the degree to which WCF activities devote capital to inventories. A higher ratio will indicate that inventory does not remain in stock for extended periods. Managers will want to minimize the amount of capital dedicated to inventories, while still maintaining adequate stocks for customers.

$$\text{Inventory Turnover Ratio} = \frac{\text{Cost of Goods Sold During FY}}{\text{Average Inventory In FY}}$$

- **Average Number of Days Inventory in Stock**

- Used to calculate the average number of days that inventory is held until transferred. Most private sector firms will seek to minimize the the number of days that inventory is held in stock.

$$\text{Avg. No. of Days Inventory in Stock} = \frac{365 \text{ Days}}{\text{Inventory Turnover Ratio}}$$



- **Accounts Receivable Turnover Ratio**

- Measures the efficiency in the WCF's credit policies to customers and the level of capital needed to maintain the WCF's sales level.

$$\begin{array}{l} \text{Accounts Receivable} \\ \text{Turnover Ratio} \end{array} = \frac{\text{Sales During FY}}{\text{Average Accounts Receivable In FY}}$$

- **Average Number of Days of Accounts Receivable Outstanding**

- Directly tied to the A/R Turnover Ratio and indicates the term of credit extended to customers. WCF activities should seek to minimize the number of days and the financing of customers' purchases.

$$\begin{array}{l} \text{Avg. No. of Days} \\ \text{Receivables Outstanding} \end{array} = \frac{365 \text{ Days}}{\text{A/R Turnover Ratio}}$$



- **Accounts Payable Turnover Ratio**

- Measures the timing of payment to WCF suppliers. The management of the time between payment to suppliers and receipt of payment from customers is critical for WCFs.

$$\text{Accounts Payable Turnover Ratio} = \frac{\text{Purchases During FY}}{\text{Average Accounts Payable In FY}}$$

- **Average Number of Days of Accounts Payable Outstanding**

- This figure should be directly compared to the Average Number of Days of Accounts Receivable Outstanding and ideally it should be greater than the A/R figure. If the A/P figure is less than the A/R figure, the WCF activity could be under financial constraint by the extension of unavailable credit to customers.

$$\text{Avg. No. of Days of Accounts Payable Outstanding} = \frac{365 \text{ Days}}{\text{A/P Turnover Ratio}}$$



- **Working Capital Turnover Ratio**

- Reflects the amount of working capital funds needed to maintain a given level of sales. The calculation of Average Working Capital should exclude short term debt payable and excess cash on hand.

$$\text{Working Capital Turnover Ratio} = \frac{\text{Sales During FY}}{\text{Average Working Capital In FY}}$$